

No. 82-1766

Office-Supreme Court, U.S.
FILED

JUL 22 1983

ALEXANDER L. STEVAS,
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, ET AL.,
PETITIONERS

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

REX E. LEE

Solicitor General

J. PAUL McGRATH

Assistant Attorney General

ANTHONY J. STEINMEYER

Attorney

Department of Justice

Washington, D.C. 20530

(202) 633-2217

MICHAEL BRADFIELD

General Counsel

RICHARD M. ASHTON

Assistant General Counsel

Board of Governors of the Federal Reserve System

Washington, D.C. 20551

QUESTION PRESENTED

Whether the court of appeals correctly upheld a ruling by the Board of Governors of the Federal Reserve System that a certain type of commercial paper—short-term promissory notes issued by large, financially sound businesses in very large denominations to meet their current needs and sold to a small number of financially sophisticated purchasers that regularly purchase short-term credit instruments—is in economic reality a commercial loan and not a security for purposes of the Glass-Steagall Act.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statutes involved	2
Statement	2
Argument	8
Conclusion	19

TABLE OF AUTHORITIES

Cases:

<i>American Fletcher Mortgage Co. v. United States Steel Credit Corp.</i> , 635 F.2d 1247 .	17
<i>Board of Governors of Federal Reserve System v. Investment Company Institute</i> , 450 U.S. 46	14, 19
<i>FEC v. Democratic Senatorial Campaign Committee</i> , 454 U.S. 27	8
<i>Investment Company Institute v. Camp</i> , 401 U.S. 617	11, 12, 14, 17, 18
<i>Jarecki v. G.D. Searle & Co.</i> , 367 U.S. 303	13
<i>Marine Bank v. Weaver</i> , 455 U.S. 551	10, 14
<i>Philbrook v. Glodgett</i> , 421 U.S. 707	12
<i>Teamsters v. Daniel</i> , 439 U.S. 551	14
<i>Third National Bank in Nashville v. Impac, Ltd.</i> , 432 U.S. 312	13
<i>Union Planters National Bank of Memphis v. Commercial Credit Business Loans, Inc.</i> , 651 F.2d 1174, cert. denied, 454 U.S. 1124	17

IV

Cases—Continued:	Page
<i>United American Bank of Nashville v. Gunter</i> , 620 F.2d 1108	17
<i>United Housing Foundation, Inc. v. Forman</i> , 421 U.S. 837	9, 14
<i>United States v. Heirs of Boisdore</i> , 49 U.S. (8 How.) 113	12
Statutes:	
Banking Act of 1933:	
Section 5, 12 U.S.C. 335.....	2
Section 16, 12 U.S.C. (Supp. V) 24	
Seventh	2, 6, 10, 11, 12
Section 21, 12 U.S.C.	
378(a)(1)	2, 6, 10, 12, 13
Securities Act of 1933, 15 U.S.C. (& Supp. V) 77a <i>et seq.</i> :	
15 U.S.C. 77b(1).....	13
15 U.S.C. 77c(a)(3).....	3
Securities Exchange Act of 1934, 15 U.S.C. (& Supp. V) 78a <i>et seq.</i> :	
15 U.S.C. 78c(a)(10).....	3, 13
15 U.S.C. 78o(a)(1)	3
Miscellaneous	
American Banker (Feb. 25, 1983)	18
75 Cong. Rec. 9904 (1932)	15
77 Cong. Rec. 3835 (1933)	15
1 A. Dewing, <i>The Financial Policy of Corporations</i> , (5th ed. 1953).....	12, 13
67 Fed. Res. Bull. A26 (Dec. 1981)	15
69 Fed. Res. Bull. A26 (June 1983)	3

Miscellaneous—Continued:

	Page
Hurley, <i>The Commercial Paper Market</i> , 63 Fed. Res. Bull. 525 (June 1977) . . . 3, 15-16, 18	
Hurley, <i>The Commercial Paper Market Since the Mid-Seventies</i> , 68 Fed. Res. Bull. 327 (June 1982)	16
G. Munn, <i>Encyclopedia of Banking and Fi- nance</i> (7th ed. 1973)	13
<i>Operation of the National and Federal Re- serve Banking Systems: Hearings on S. 4115 Before the Senate Comm. on Bank- ing and Currency</i> , 72d Cong., 1st Sess., Pt. 1, (1932)	15
Pollock, <i>Notes Issued in Syndicated Loans—A New Test to Define Securities</i> , 32 Bus. Law. 537 (1977)	17
S. 1720, 97th Cong., 1st Sess. (1981)	11
S. Rep. No. 77, 73d Cong. 1st Sess. (1933) .	15
S. Rep. No. 96-368, 96th Cong., 1st Sess. (1979)	10
H. Willis & J. Bogen, <i>Investment Banking</i> (1936)	17

In the Supreme Court of the United States

OCTOBER TERM, 1983

No. 82-1766

SECURITIES INDUSTRY ASSOCIATION, ET AL.,
PETITIONERS

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE DISTRICT OF COLUMBIA CIRCUIT*

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-38a) is reported at 693 F.2d 136. The opinion of the district court (Pet. App. 39a-64a) is reported at 519 F. Supp. 602. The statement of the Board of Governors of the Federal Reserve System denying the petitions to initiate enforcement action (Pet. App. 65a-86a) is not reported. The Board's Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks (Pet. App. 87a-93a) is reported at 46 Fed. Reg. 29333.

JURISDICTION

The judgment of the court of appeals was entered on November 2, 1982. A petition for rehearing was denied on February 2, 1983 (Pet. App. 95a-98a). The petition

for a writ of certiorari was filed on April 29, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

1. Section 16 of the Banking Act of 1933 (the "Glass-Steagall Act"), 12 U.S.C. (Supp. V) 24 Seventh, provides in pertinent part:

The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [national bank] shall not underwrite any issue of securities or stock * * *.^[1]

2. Section 21 of the Glass-Steagall Act, 12 U.S.C. 378(a)(1), provides in pertinent part:

[I]t shall be unlawful * * * [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing * * * stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits * * *.

STATEMENT

1. The term "commercial paper," as used herein, refers to promissory notes that are of prime quality, bear very short-term maturities (usually 60 days or less), and are issued by large, well-known, financially strong corporations to obtain funds for seasonal or other current needs. Commercial paper is not offered to the general public, but rather is sold to large, financially so-

¹ Section 5 of the Act, 12 U.S.C. 335, provides that state-chartered banks that are members of the Federal Reserve System shall be subject to the same limitations and conditions with respect to dealing in securities that are applicable to a national bank.

phisticated purchasers, predominantly institutions such as money market mutual funds, pension funds, and bank trust departments. Corporations issuing commercial paper place the paper with purchasers either directly or through dealers.² Commercial paper that is placed through dealers is sold in very large denominations, usually no smaller than \$100,000 and averaging \$1 million or more. Pet. App. 4a, 65a-66a; see also Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525, 527-528 (June 1977) ("Hurley").

Because of its very short maturity and because it represents obligations of only the largest, best-known corporations with established credit ratings, commercial paper generally is a very low risk instrument. The rates paid on commercial paper are usually somewhat lower than the prime rate paid on short-term bank loans and slightly higher than the rates on short-term obligations of the United States. Pet. App. 65a-66a, 89a; see also Hurley, *supra*, 63 Fed. Res. Bull. at 525. Commercial paper is not registered pursuant to the Securities Act of 1933, and dealers that engage exclusively in placing commercial paper are not subject to the broker-dealer registration requirements of the Securities Exchange Act of 1934. 15 U.S.C. 77c(a)(3), 78c(a)(10), 78o(a)(1).

2. During 1978, Bankers Trust Company, a New York-chartered member bank of the Federal Reserve System, began placing commercial paper of corporations not related to it ("third party commercial paper") as agent of the issuers. Bankers Trust does not commit to purchase for itself any unsold amounts of commercial paper it attempts to place, but does extend credit to the corporations whose paper it has placed, although for only a small portion of any unsold amount of the issue. Pet. App. 4a-5a, 66a.

² As of the end of April 1983, at least half of the commercial paper outstanding was placed directly by issuers. 69 Fed. Res. Bull. A26 (June 1983).

Petitioners, the Securities Industry Association ("SIA"), a securities industry trade association, and A.G. Becker, Inc., a commercial paper dealer, informally expressed concern to Board staff members regarding the legality of Bankers Trust's commercial paper activities. SIA and Becker subsequently petitioned the Board to initiate formal administrative enforcement action to restrain such activities. Pet. App. 3a, 65a.

On September 26, 1980, after considering information obtained through informal discussions with, and written submissions by, the interested parties, as well as through an on-site examination by the Board staff of Bankers Trust's commercial paper activities (Pet. App. 5a),³ the Board denied the petitions of SIA and Becker to the extent they alleged violations of the Glass-Steagall Act or activities contrary to public policy. *Id.* at 85a. The Board issued a statement (*id.* at 65a-86a) explaining the reasons for its conclusion that the commercial paper being sold by Bankers Trust is not a security for purposes of the Glass-Steagall Act and, thus, is not subject to the Act's prohibitions against underwriting and dealing in securities.⁴

The Board first observed that Congress did not intend every instrument that could be characterized as a

³ The staff's examination of Bankers Trust's commercial paper activities revealed that the bank places only commercial paper having the highest rating from one of the services that rate commercial paper and that the customers with which the bank places commercial paper are part of the bank's established base of institutional customers that regularly purchase other short-term obligations from it. The bank does not place the commercial paper with individuals. See Pet. App. 4a, 66a.

⁴ In view of the Board's disposition of the "securities" issue, it did not reach the question whether Bankers Trust's placement of the commercial paper constituted underwriting or other activity prohibited under the Act. Pet. App. 83a. The courts below also did not reach the issue and it is not presented for resolution by this Court.

note to be a security under the Act. More specifically, it concluded that a note evidencing a transaction functionally more similar to traditional commercial banking operations than to an investment transaction was not intended to be viewed as a security under the Act. Pet. App. 74a-78a. Applying this standard to the commercial paper sold by Bankers Trust, the Board determined that such instruments represent financing transactions closer in function to commercial lending than to the sale of an investment. *Id.* at 78a-79a. The Board noted (*id.* at 78a) that historically almost all commercial paper was purchased by banks for their own accounts and thus, in essence, represented a commercial loan from a bank. The Board concluded that, although the role of banks in the commercial paper market had changed (*i.e.*, commercial banks are no longer the predominant purchasers of commercial paper), the commercial paper placed by Bankers Trust continues to have the same essential economic characteristics. Like a note evidencing a commercial loan or loan participation, the paper has very short maturities and is purchased principally by a limited number of institutions, most of whom are part of the bank's base of institutional customers that purchase short-term obligations on a regular basis, in very large denominations, *Id.* at 78a-79a.

Thereafter, the Board published a Policy Statement (the "Guidelines") containing guidelines designed to ensure that the sale of third party commercial paper by state member banks would be consistent with principles of safe banking (Pet. App. 87a-93a). The Guidelines narrowly limit the type of instruments that may be sold by providing that, among other things, a bank may place only prime quality paper, in denominations no smaller than \$100,000, and only with financially sophisticated customers, and may not advertise any commercial paper for sale to the general public. *Id.* at 91a.⁵

⁵ The Guidelines also govern the bank's credit analysis of the commercial paper issuer, the kinds of records that are to be

3. Petitioners sought judicial review of the Board's September 1980 statement that the commercial paper placed by Bankers Trust is not a security for purposes of the Glass-Steagall Act. The district court rejected the Board's conclusion that notes representing commercial transactions are not securities under the Act on the ground that any note is, *ipso facto*, a security. Pet. App. 39a-64a.

The court of appeals reversed. Pet. App. 1a-38a. It noted at the outset (*id.* at 7a-11a) that the district court had applied the wrong standard of review by failing to give sufficient weight to the Board's expertise. The court held that deference to the Board's interpretation is warranted in this case because of the broad scope of the Board's authority over the banking system, the Board's expert knowledge of commercial banking, the general, undefined nature of the relevant statutory terms—notes and securities, and the thorough quality of the review and the findings made by the Board and their consistency with previous rulings. *Id.* at 8a-10a.

The court of appeals did not, however, "rest merely on the deference to the conclusions of the Federal Reserve Board." Pet. App. 11a. Instead, recognizing that the courts are the final arbiters of the meaning of a statute, the court below undertook an independent analysis of the application of the Glass-Steagall Act to this case. Based on its own examination of the language of Sections 16 and 21 of the Act, the relevant legislative history and the fundamental purposes underlying the Act, the court of appeals found "essentially correct" the Board's ruling that the commercial paper placed by Bankers Trust is not a security within the meaning of the Glass-Steagall Act and that only notes of an investment character are "securities" for purposes of the Act. Pet. App. 11a-19a.

maintained, avoidance of conflicts of interest, and disclosures to purchasers. Pet. App. 91a-93a.

The court first examined the statutory language and legislative history of the Act. Pet. App. 13a-19a. Finding those sources "strongly suggest[ive]" of the notion that the placement of commercial paper is not a sale of securities for purposes of the Glass-Steagall Act (Pet. App. 17a, 19a, 22a), the court went on to analyze the functional nature of the underlying transaction at issue and concluded that it does not involve the types of hazards and dangers at which the Act is aimed. *Id.* at 22a-25a.⁶ As the Board had, the court of appeals determined that the commercial paper placed by Bankers Trust has the economic characteristics of a short-term commercial loan: the default rate on commercial paper is extremely low (lower than on ordinary bank commercial loans), the maturities are very short, and the paper is placed only with sophisticated purchasers that have the resources to verify representations made by and about the issuers. *Id.* at 25a-27a. The court acknowledged that Bankers Trust is selling an obligation, rather than purchasing one, as in the case of a typical commercial loan. The court concluded, however, that the function of the bank in the transaction is not determinative, since the bank's role as seller would not result in the funds of bank depositors being tied up in speculative investments or present significant conflicts of interest, the dangers the Act was designed to prevent. *Id.* at 28a-30a.⁷

⁶ The court of appeals held that the definition of a security in the federal securities laws is not determinative of the meaning of the term "securities" in the Glass-Steagall Act since the laws were enacted for fundamentally different purposes. As the court observed, the securities laws were enacted for the protection of investors, while the Glass-Steagall Act was designed to protect banks and their depositors. Pet. App. 20a-22a.

⁷ The court of appeals emphasized (Pet. App. 30a-31a) that its reasoning is limited to the particular type of instrument involved in this case and that other obligations, even other types of commercial paper, such as obligations of smaller denomina-

Judge Robb dissented, concluding that if an obligation is sold (rather than purchased) by a bank, that obligation necessarily is a security for purposes of the Act. Pet. App. 31a-38a.

ARGUMENT

Petitioners challenge the standard of review employed by the court of appeals as well as the authority of the Board to issue the ruling below and the correctness of that ruling. As we show below, however, both the court of appeals and the Board applied settled principles of administrative law in ruling that the commercial paper at issue here is not a security within the meaning of the Glass-Steagall Act. Moreover, that decision is correct and does not conflict with any decision of this Court or any other court of appeals. Further review therefore is not warranted.

1. In *FEC v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981), the Court made clear that, in reviewing an agency's interpretation of a statute, the task for the court is "not to interpret the statute as it [thinks] best but rather the narrower inquiry into whether the [agency's] construction was 'sufficiently reasonable' to be accepted by a reviewing court." The Court noted (*id.* at 37) that the breadth of the agency's authority and the thoroughness, validity and consistency of its reasoning "are factors that bear upon the amount of deference to be given an agency's ruling."

The court below faithfully applied this Court's instructions in holding (Pet. App. 8a-10a) that the Board's construction of the Glass-Steagall Act is entitled to deference in view of the Board's comprehensive authority over the nation's banking system, its expert knowledge of commercial banking, the general, unde-

tions or obligations that are distributed to the public generally, might well be securities within the meaning of the Act.

finer nature of the statutory terms at issue, the Board's thorough review and exploration of the issues and the ruling's consistency with past Board interpretations.

Moreover, the court of appeals did not "rest merely on the deference to the conclusions of the Federal Reserve Board." Rather, as described above (pages 6-7, *supra*), the court undertook its own "inquiry into the language and legislative history of the statute, and the policies underlying it." Pet. App. 11a. As a result, the court concluded (*ibid.*) that the Board's "ruling and the reasoning which supports it are essentially correct."

2. Petitioners' suggestion (Pet. 8-10) that the decision below sanctions the use of rulemaking by the Board to expand the statutory limitations on bank securities activities is unfounded.

It is evident that, in reaching the conclusion that the commercial paper at issue here is not a security within the meaning of the Glass-Steagall Act, the Board merely found that a certain statutory standard did not apply to a particular set of facts. Pet. App. 69a-83a. As the court of appeals noted (*id.* at 9a), in view of the broad, undefined nature of the language employed in the Act—"note" and "securities"—it is incumbent on the Board to identify on a case-by-case basis the particular circumstances in which these terms apply, particularly because the class of instruments covered by the statute necessarily would change as business reality in the financial markets changes.⁸

Such administrative line-drawing is inherently the function of an agency charged with the administration of a statute, especially one that contains such broad terms as "securities" and "notes." See *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 848 (1975)

⁸ The court of appeals pointed out that the current situation in the commercial paper market could not have been foreseen by Congress when the Act was passed since the market has changed substantially since that time. Pet. App. 9a.

(the SEC and the federal courts must "decide which of the myriad financial transactions in our society" come within the definition of security contained in the federal securities laws); see also *Marine Bank v. Weaver*, 455 U.S. 551, 560 n.11 (1982) (in applying the definition of security contained in the federal securities laws, "[e]ach transaction must be analyzed and evaluated on the basis of the * * * factual setting as a whole"). Hence, rather than presenting "novel" issues of administrative authority, this case is one of the multitude of cases in which an agency has merely clarified or explained a provision in a statute or rule with whose administration it is charged.⁹

Petitioners' additional reliance (Pet. 11) on a number of recent interpretations of the Act by various financial supervisory agencies¹⁰ also is misplaced. The subject matter of each of those rulings—the scope of permissible securities brokerage, the extent to which individual retirement trusts may be commingled, and the unique limitations applicable to securities activities of subsidiaries of banks—is wholly distinguishable from the placement of commercial paper on which the Board

⁹ Because the court of appeals sanctioned no administrative rulemaking, the fact that Congress may have withheld such authority on past occasions is of no significance. Indeed, the legislative history of the limitations placed on the Comptroller of the Currency's rulemaking authority under the Glass-Steagall Act demonstrates that Congress understood the distinction between interpreting the Act (which the court of appeals sanctioned here) and rulemaking under the Act. See S. Rep. No. 96-368, 96th Cong., 1st Sess. 13 (1979) (emphasis added) ("The Comptroller shall not use formal rulemaking authority, as opposed to interpretive rulings which are requested from time to time, to decide issues related to the Glass-Steagall Act").

¹⁰ The Comptroller of the Currency interprets Sections 16 and 21 of the Act with respect to national banks. The FDIC interprets Section 21 with respect to state chartered banks that are not members of the Federal Reserve System.

ruled in this case. Those cases are not dependent upon the disposition of this case, indeed, none of those recent opinions relies on or even cites the ruling of the Board at issue here.¹¹

3 a. The thrust of petitioners' challenge to the merits of the decision below is that the plain language of the Glass-Steagall Act requires its application to every debt instrument that may be characterized as a note. As we show below, however, when viewed in context, the plain language of the Act, rather than advancing petitioners' argument, "strongly [supports the ruling below] that sale of commercial paper should be treated as a 'loan' rather than a sale of securities for purposes of the Act." Pet. App. 17a.

Section 16 of the Act, 12 U.S.C. (Supp. V) 24 Seventh, prohibits banks, with certain exceptions, from underwriting or dealing in "securities or stock." Significantly, this provision was added by the Glass-Steagall Act to provisions of the National Bank Act that expressly authorize a national bank to discount and negotiate "promissory notes" and "other evidences of debt." See 12 U.S.C. (Supp. V) 24 Seventh. Plainly, then, Section 16 does not prohibit bank underwriting and dealing with respect to all notes, but only with respect to those notes that qualify as "securities."¹² And the

¹¹ Equally without significance is the fact that recent proposed legislation modifying the Act has not as yet been enacted. This proposed legislation is not addressed to third party commercial paper but deals instead with activities such as the underwriting of mutual funds and revenue bonds within the context of a comprehensive restructuring of the financial markets. See S. 1720, 97th Cong., 1st Sess. (1981).

¹² For the same reason, petitioners' reliance (Pet. 14) on *Investment Company Institute v. Camp*, 401 U.S. 617, 635 (1971) ("*ICI I*"), also is misplaced. There, the Court merely noted (*ibid.*; emphasis added) that the Act covers "*securities* representing debt," not that every debt instrument is a "*security*" within the meaning of the statute. To be sure, in *ICI I* the

Section provides no guidance concerning whether commercial paper is included within the statutory prohibition.

Section 21 of the Act, 12 U.S.C. 378(a)(1), which forbids banks from issuing or underwriting "stocks, bonds, debentures, notes, or other securities," also is more supportive of the Board's ruling than of petitioners' position. Although the word "notes," when viewed in isolation, may be ambiguous, when it is properly read in the context of the provision as a whole,¹³ it is clear that the term was not intended to include the commercial paper at issue here.

As the court of appeals observed (Pet. App. 15a & n.46), the terms "stocks," "bonds," and "debentures" each refer to specific, well-recognized types of permanent or long-term securities. Bonds, for example, are secured debt instruments, issued under a trust indenture agreement, that are offered to the public generally in small denominations and that bear maturities of from five to 30 years. See Pet. App. 15a n.46; 1 A. Dewing, *The Financial Policy of Corporations* 171-179 (5th ed. 1953) ("Dewing").¹⁴ Many corporations offer to the pub-

Court also indicated (*ibid.*) that the word "securities," as used in Sections 16 and 21 of the Glass-Steagall Act, should not be narrowly construed. But in that case the Court was considering the status of equity interests in a mutual fund that operated essentially as an open-end investment company, and the Court had found "direct evidence" in the legislative history that Congress had had such ventures specifically in mind when it passed the Glass-Steagall Act. 401 U.S. at 635. By contrast, no one has identified any legislative history that suggests that the type of sale in which Bankers Trust is engaged was a practice with which the drafters of the Glass-Steagall Act were concerned.

¹³ "In expounding a statute, [this Court is not] guided by a single sentence or member of a sentence, but look[s] to the provisions of the whole law, and to its object and policy." *Philbrook v. Glodgett*, 421 U.S. 707, 713 (1975), quoting *United States v. Heirs of Boisdore*, 49 U.S. (8 How.) 113, 122 (1849).

¹⁴ Debentures have the same characteristics as bonds except that they are unsecured. Stocks represent ownership interests in a corporation. Pet. App. 15a n.46.

lic debt instruments, referred to as "notes," that have the same characteristics as bonds or debentures, except that they bear maturities of from one to five years. *Dewing, supra*, at 178.¹⁵ The term "note" also refers, however, to any written promise to pay a sum of money. See Pet. App. 15a & n.44; G. Munn, *Encyclopedia of Banking and Finance* 698 (7th ed. 1973). It is on this more generic usage that petitioners rely. But Congress's use of the word "notes" in conjunction with other terms that refer to specific types of long-term investment securities is strong evidence that it also intended the similar, narrower meaning of "notes" in Section 21 of the Glass-Steagall Act.¹⁶

¹⁵ As discussed below (pages 15-16, *infra*), commercial paper bears none of these characteristics.

¹⁶ "It is a familiar principle of statutory construction that words grouped in a list should be given related meaning." *Third National Bank in Nashville v. Impac, Ltd.*, 432 U.S. 312, 322 (1977) (footnote omitted); see also *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961) ("a word is known by the company it keeps"). The Board's interpretation thus is grounded squarely on the language of the statute, since Congress's use of words of specific meaning in Section 21 demonstrates "on the face of the statute" that the broadest possible meaning of the word "notes" was not intended. See *Jarecki v. G.D. Searle & Co., supra*, 367 U.S. at 307-308. In addition, if Congress had used the word "notes" in its generic sense in Section 21, there would have been no reason for it to have included "bonds" and "debentures" in the statutory litany, since those instruments are encompassed within the generic meaning of the word "note." See Pet. App. 15a-16a.

Petitioners' reliance on the definition of security in the securities laws is misplaced. While the Glass-Steagall Act refers to "notes" only in conjunction with certain specified, long-term capital obligations, the Securities Act of 1933 and Securities Exchange Act of 1934 define security to include "any note." 15 U.S.C. 77b(1) and 78c(a)(10). This difference in language demonstrates that Congress knew how to formulate a more inclusive definition than that found in the Glass-Steagall Act. More importantly, since the Glass-Steagall Act and the securities laws

b. Our reading of the statutory language (pages 11-13, *supra*) is bolstered by the functional analysis employed by the Board and the court below, whereby they concluded that the commercial paper at issue here is not the type of instrument with which the drafters of the Act were concerned.¹⁷

This Court has consistently recognized that the Glass-Steagall Act was designed to prohibit commercial banks from engaging in the investment banking business, not to bar them from traditional banking functions. See, e.g., *Board of Governors of Federal Reserve System v. Investment Company Institute*, 450 U.S. 46, 55, 59-63 (1981) (Glass-Steagall Act would not necessarily prohibit a bank from acting as an investment adviser); see also *Investment Company Institute v. Camp*, 401 U.S. 617, 629 (1971). Indeed, the legislative history of the Glass-Steagall Act makes clear that its drafters

were enacted to accomplish different purposes, there is no basis to assume that an instrument that must be deemed a security in order to carry out the purposes of the securities laws must also be considered a security to give effect to the objectives of the Glass-Steagall Act. Compare *United Housing Foundation, Inc. v. Forman*, *supra*, 421 U.S. at 849 (securities laws designed to protect investors) with *Board of Governors of Federal Reserve System v. Investment Company Institute*, 450 U.S. 46, 61 (1981) ("ICI II") (Glass-Steagall Act designed to protect banks and depositors). In any event, despite the very broad definitions in the securities laws, not every obligation that can be characterized as a note is a security under those laws. *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982) (bank certificate of deposit not a security).

¹⁷ The approach employed by the Board and the court of appeals is consistent with this Court's instruction that the determination whether a particular interest constitutes a "security" within the meaning of the federal securities laws turns on "the economic realities underlying a transaction, and not on the name appended thereto." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 (1975). Accord, *Marine Bank v. Weaver*, *supra*; *Teamsters v. Daniel*, 439 U.S. 551, 558-559 (1979).

not only were not concerned with the sale of commercial paper but, moreover, intended the legislation to channel banking activities back into that traditional field of commercial practice. See, *e.g.*, S. Rep. No. 77, 73d Cong., 1st Sess. 4 (1933) (emphasis added) (one of the unsound practices the Act was designed to restrain was "a loose banking policy which had turned from the making of loans on *commercial paper* to the making of loans on *security*"); 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott) (emphasis added) (decrying the pre-panic trend whereby business enterprises "began to finance their requirements by the sale of their own securities *rather than by borrowing at the commercial banks upon their commercial paper—that is, upon their own notes*").¹⁸

Applying a functional analysis, both the Board and the court of appeals correctly concluded (Pet. App. 25a-27a, 78a-79a) that the commercial paper at issue here has all of the essential characteristics of a commercial loan. Commercial paper has a very low default rate, indeed, even lower than that of most commercial bank loans. *Id.* at 89a. Also like most commercial loans, the paper has very short maturities (30 to 90 days). See Hurley, *supra*, 63 Fed. Res. Bull. at 530; 67 Fed. Res. Bull. A26 (Dec. 1981). Finally, like commercial loans, commercial paper is purchased in very large denominations by only sophisticated purchasers such as money market mutual funds, pension funds, bank trust departments, and nonfinancial corporations with large amounts of idle cash and the resources to evaluate the creditworthiness of the issuing corporations. See Hur-

¹⁸ See also, *e.g.*, *Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*, 72d Cong., 1st Sess., Pt. 1, 146 (1932) (remarks of Sen. Glass); *id.* at 66-67 (remarks of Harry J. Haas, president of the American Bankers Association); 77 Cong. Rec. 3835 (1933) (remarks of Rep. Steagall).

ley, *supra*, at 529.¹⁹ Because the commercial paper at issue here is the practical equivalent of a commercial loan, which undisputably was not a target of the Glass-Steagall Act (see pages 14-15, *supra*), it is not a "security" within the meaning of the legislation.²⁰

To be sure, Bankers Trust is selling, rather than purchasing, the commercial paper at issue here. Contrary to petitioners' assertion, however, the role of the bank vis-a-vis the purchaser-lender is not dispositive.²¹

¹⁹ Money market mutual funds alone hold more than one-third of all commercial paper outstanding. Hurley, *The Commercial Paper Market Since the Mid-Seventies*, 68 Fed. Res. Bull. 327, 333 (June 1982).

²⁰ Contrary to petitioners' assertion (Pet. 15), neither the holding nor the rationale of the court of appeals' opinion permits banks to underwrite short-term bonds or debentures or other types of debt instruments. In ruling as they did, both the Board and the court of appeals expressly relied (Pet. App. 25a, 27a, 79a, 91a) on each of the characteristics listed in the text above. On the other hand, the broad array of instruments commonly known as securities bears none of the qualities relied on by the court of appeals. Bonds, debentures, and investment notes entail greater risk than commercial paper, have maturities in excess of 30-90 days, and are distributed in small denominations to the public. By its express reliance on the features of the commercial paper at issue here that distinguish it from the instruments designated in the Act, the court of appeals expressly made clear that its holding does not control other debt instruments having one or more different characteristics. *Id.* at 31a.

²¹ Likewise, the dissent's assertion (Pet. App. 32a) that the critical distinction between commercial banking and investment banking is the bank's role in the transaction is supported neither by the Act's provisions nor by the realities of the Nation's financial markets. For example, a text on investment banking written at approximately the time of the Act's passage states that the most common factor used in making rough practical distinctions between commercial and investment banking is that of *time*—commercial banking involving short-term advances to borrowers and investment banking involving long-term ad-

Traditional commercial banking practices also include the syndication of commercial loans, whereby banks market notes of the borrower to other lenders (see Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Law. 537, 538 (1977)), a type of transaction to which Bankers Trust's activities here also may be analogized.²²

In any event, the role played by Bankers Trust in this case cannot convert what would otherwise be a commercial interest into a "security" within the meaning of the Glass-Steagall Act because the bank's placement of commercial paper does not give rise to the types of risks against which that legislation was directed. See *ICI I*, *supra*, 401 U.S. at 630-634. In the first place, there is no danger that the bank would invest its own assets in "frozen or otherwise imprudent" investments (*id.* at 630). As noted above (page 5, *supra*), historically almost all commercial paper was purchased by banks for their own account. Moreover, the default rate on commercial paper sold in the recognized commercial paper market is far lower than the de-

vances usually represented by securities. H. Willis & J. Bogen, *Investment Banking* 6 (1936).

²² Three courts of appeals recently have held that a loan participation is not a "security" within the meaning of the federal securities laws. See, e.g., *Union Planters National Bank of Memphis v. Commercial Credit Business Loans, Inc.*, 651 F.2d 1174, 1179-1185 (6th Cir.), cert. denied, 454 U.S. 1124 (1981); *American Fletcher Mortgage Co. v. United States Steel Credit Corp.*, 635 F.2d 1247, 1253-1255 (7th Cir. 1980) (loan participation bore indicia of a commercial loan rather than a security); *United American Bank of Nashville v. Gunter*, 620 F.2d 1108, 1115-1119 (5th Cir. 1980). Simply because the bank in this case did not commit to purchase for itself the unplaced commercial paper cannot transform the nature of the paper that is placed from a commercial loan to a "security."

fault rate on ordinary commercial loans by banks. Pet. App. 89a.²³ Hence, even if a bank placing commercial paper were forced to purchase such paper for its own account, the funds of its depositors would be subject to *less* risk of loss than if the bank has used the funds to make ordinary commercial loans.²⁴

Nor would a bank be tempted to make unsound loans to facilitate the purchase of commercial paper or to shore up issuers of paper, see *ICI I, supra*, 401 U.S. at 631-632, because the nature of the market is such that commercial paper is not purchased with borrowed funds and is issued only by the financially strongest businesses. Pet. App. 89a. So also, there is no risk to the bank's good will or reputation for prudence, or any danger that the bank would give unreliable investment advice, see *ICI I, supra*, 401 U.S. at 631-632, because commercial paper is not placed with the bank's depositors generally, is issued only by highly-solvent corporations, and is held by financially sophisticated purchas-

²³ The 1970 default involving commercial paper of Penn Central, on which petitioners rely (Pet. 18), was the most recent default by a company placing paper in the recognized commercial paper market and, accordingly, constitutes an isolated case that is not representative of risk in the market. The commercial paper market has developed numerous safeguards to assure that the paper placed therein is paid at maturity. Commercial paper issuers, for example, maintain back-up lines of credit from a commercial bank that can be drawn upon to pay outstanding paper at maturity if the issuer is facing financial difficulties. Hurlley, *supra*, at 530. The risk of loss on commercial paper thus is insignificant in comparison to possible losses on a commercial loan by a bank. Indeed, in 1982 alone, one large Chicago Bank suffered loan losses of more than \$390 million. American Banker, Feb. 25, 1983, at 3, col. 1.

²⁴ Petitioners' attempt (Pet. 17) to denigrate the importance of the low-risk nature of the commercial paper at issue here also cannot succeed. As *ICI I* makes clear (401 U.S. at 634-639), risk is one factor in the determination whether a particular instrument is a security.

ers that have the resources to make their own judgment concerning the risk of purchase. Pet. App. 89a-90a.²⁵

Finally, the mere existence of a promotional interest or the earning of income through a fee is not, as petitioners suggest (Pet. 16-17), one of the evils against which the Act was directed; otherwise the Act would prohibit a bank from providing traditional banking services, such as selling its own deposit instruments or providing investment advice (see *ICI II*, *supra*, 450 U.S. at 55-56), which also involve promotional interest and fee income. Rather, the Act plainly was designed to proscribe only those promotional incentives that are inherent in the *securities* markets.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE

Solicitor General

J. PAUL McGRATH

Assistant Attorney General

ANTHONY S. STEINMEYER

Attorney

MICHAEL BRADFELD

General Counsel

RICHARD M. ASHTON

Assistant General Counsel

*Board of Governors of the
Federal Reserve System*

JULY 1983

²⁵ Petitioners' challenge (Pet. 17) to the Guidelines issued by the Board (Pet. App. 87a-93a) is without merit, since the Board found the commercial paper at issue here outside the purview of the Act. Hence, the Guidelines simply assure that banks do not engage in transactions covered by the Act and do not violate safe banking principles.